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In the Supreme Court of the United States

OCTOBER TERM, 1983

CHRISTOPHER L. LOWE, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether the First Amendment renders invalid the authority granted the Securities and Exchange Commission by the Investment Advisers Act of 1940 to deny or revoke the registration of a publisher of an investment advisory service on the basis of prior criminal conduct.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A39) is reported at 725 F.2d 892. The opinion of the district court (Pet. App. A41-A67) is reported at 556 F. Supp. 1359.

JURISDICTION

The judgment of the court of appeals was entered on January 18, 1984. A petition for rehearing was denied on February 22, 1984. The petition for a writ of certiorari was filed on May 16, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Christopher L. Lowe is the president of three corporations — petitioners Lowe Management Corporation, Lowe Publishing Corporation, and Lowe Stock Chart Service, Inc. — through which he has published and distributed two subscription investment advisory services and has solicited subscriptions for a third (Pet. App. A3, A9). Between March 29, 1974, and May 11, 1981, Lowe Management was registered with the Securities and Exchange Commission as an investment adviser pursuant to Section 203(c) of the Investment Advisers Act of 1940 (the Act), 15 U.S.C. 80b-3(c) (Pet. App. A3).

In 1977, Lowe was convicted of two New York misdemeanors relating to his investment advisory business — defrauding an advisory client and failing to register as an investment adviser in New York State (Pet. App. A3). In 1978, Lowe was convicted of two New York felonies — tampering with physical evidence in a state criminal proceeding arising out of an advisory client's complaint and grand larceny involving fraudulent checks (*ibid.*; C.A. App. 9-10, 124-125). As a result of these convictions, the Commission instituted an administrative disciplinary proceeding under Sections 203(e) and (f) of the Act, 15 U.S.C. 80b-3(e) and (f), against Lowe and Lowe Management (Pet. App. A4). In that proceeding, the Commission found that Lowe willfully aided and abetted violations by Lowe Management of the antifraud and reporting provisions of the Act, including misappropriation of an advisory client's funds (Pet. App. A4).[1] The Commission also invoked the

[1] *In re Lowe Management Corp.*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 82,873 (May 11, 1981).

provisions of Sections 203(e) and (f) that made certain of Lowe's New York convictions a separate basis for administrative sanctions.[2]

In assessing what sanctions were appropriate in the public interest, the Commission found that Lowe's conduct "could hardly be more serious" and reflected a "callous disregard" for the high fiduciary standards required of an investment adviser (Pet. App. A4). Accordingly, the Commission issued an order on May 11, 1981, revoking the registration of Lowe Management as an investment adviser and barring Lowe from association with any investment adviser (*ibid.*). Neither Lowe nor Lowe Management sought judicial review of the Commission's order.[3]

Despite the Commission's order, Lowe thereafter published and distributed through his corporations two investment advisory services — the *Lowe Investment and Financial Letter* (the *Lowe Letter*) and the *Lowe Stock Advisory*. In addition, Lowe solicited subscriptions for a third service, the *Lowe Stock Chart Service*, and offered a recorded telephone "hotline" service said to provide "up-to-the-minute advice" on the market. Pet. App. A5.

The *Lowe Letter* consists of predictions of general trends and developments in securities and other markets, followed by advice about specific securities and other investments (Pet. App. A5-A6; C.A. App. 138-189). The *Lowe Stock Advisory* typically contains a brief introductory examination of general market trends followed by specific purchase, sale and hold recommendations, particularly for low-priced stocks (Pet. App. A6; C.A. App. 192-201). The *Lowe Stock*

[2] *In re Lowe Management Corp.*, *supra*.

[3] Subsequently, Lowe pleaded guilty to two charges under New Jersey law of theft by deception in the third degree, for fraudulently misrepresenting that worthless checks were good and negotiable (Pet. App. A5).

Chart Service has solicited subscriptions, distributing sample charts that analyze the trading patterns of selected securities and provide information concerning the projected future earnings of corporate issuers (C.A. App. 202-209).

2. The Commission brought the present action in the United States District Court for the Eastern District of New York, seeking an order enjoining Lowe and his three corporations from providing investment advice in violation of the Act's registration provisions, enforcing the Commission's 1981 order, and directing disgorgement of subscription monies received (Pet. App. A45).[4] The district court recognized that, in light of Lowe's past criminal conduct, "[t]he SEC's lack of confidence in Lowe is not without basis," but nevertheless refused to enjoin publication of the advisory letters (*id.* at A42). The court reasoned that a construction of the Act that would authorize the Commission to deny or revoke the registration of an advisory publisher for past misconduct would constitute an improper prior restraint in violation of the First Amendment (*id.* at A54-A55). The court therefore construed the Act as limiting the Commission's authority to revoke an adviser's registration to those advisers who provide their services in person, and not through publication (*id.* at A52). Accordingly, the court denied the Commission's request for an injunction against publication of investment advice, but granted a limited injunction prohibiting petitioners from rendering personal investment advice (*id.* at A67).[5]

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[4]The Commission also sought to enjoin violations of the antifraud provisions of Section 206 of the Act, 15 U.S.C. 80b-6, arising from Lowe's failure to disclose his New Jersey convictions and the sanctions that had been imposed by the Commission. The court of appeals did not address that aspect of the case, and it is not before this Court.

[5]The court also enjoined petitioners from providing their advice by individual letter or recorded telephone "hotline" service (Pet. App. A67).

3. The court of appeals reversed the district court's denial of an injunction against publication, holding that the Commission's authority under the Act to revoke the registration of investment advisers extends to publishers of investment advisory services and that this statutory authority does not violate the First Amendment (Pet. App. A9).[6]

The court of appeals upheld the Commission's regulation of investment advisory publishers on two independent grounds. The court first held that the challenged provisions constitute valid regulation of commercial activity. Citing *Ohralik* v. *Ohio State Bar Association*, 436 U.S. 447, 456 (1978), in which this Court pointed out that government "does not lose its power to regulate commercial activity deemed harmful to the public whenever speech is a component of that activity," the court concluded that "the provisions of the Investment Advisers Act at issue here are precisely the kind of regulation of commercial activity permissible under the First Amendment" (Pet. App. A15). The court considered the registration of advisory publishers to fall within the government's authority to license professionals and noted that "denial of a professional license for criminal conduct has been a traditional, and perhaps necessary, aspect of this type of regulation" (*id.* at A18-A19).

The court of appeals concluded alternatively that the registration of investment advisers is a valid restriction on commercial speech (Pet. App. A17). The court reasoned that the concept of commercial speech is not limited to advertising and is broad enough to encompass Lowe's publications (*ibid.*). Relying on *Friedman* v. *Rogers*, 440 U.S. 1, 15 (1979), the court concluded that "the potential for

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[6]District Judge Brieant, sitting by designation, dissented on grounds similar to those stated by the district court (Pet. App. A23-A39). Judge Van Graafeiland joined Judge Oakes' majority opinion, and filed a concurrence (*id.* at A20-A22).

deception permits government to ban potentially deceptive commercial speech," and that, "[i]n light of Lowe's history of deceptive, criminal conduct as an investment adviser, his publications may fairly be characterized as potentially deceptive commercial speech" that may properly be banned (Pet. App. A19).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Review by this Court is therefore unwarranted.

1. Only one other court of appeals has addressed the constitutional issue in this case. In a closely analogous situation, the Seventh Circuit in *Savage* v. *Commodity Futures Trading Commission,* 548 F.2d 192 (1977), considered a First Amendment challenge to the provisions of the Commodity Exchange Act that allowed the CFTC to deny an application for registration as a commodity advisory publisher on the basis of prior convictions for mail and securities fraud. The court rejected the constitutional challenge on essentially the same grounds as the court of appeals in the present case, holding that the publication of a newsletter was commercial speech and that the First Amendment does not except a business engaged in the communication of information from the regulation of its business practices. *Id.* at 197. In *SEC* v. *Suter,* No. 83-1452 (Apr. 13, 1984), the Seventh Circuit recently reaffirmed *Savage* in a case involving the Investment Advisers Act of 1940, holding that a securities advisory publication was commercial speech not subject to full First Amendment protection. The court upheld an injunction that required the publisher to submit to the Commission copies of all his advisory

publications simultaneously with their distribution to the public (slip op. 2).[7]

2. The provisions of the Investment Advisers Act of 1940 that allow the Commission to revoke the registration of an investment adviser for prior criminal conduct are valid under the First Amendment as permissible regulation both of commercial activity and of commercial speech.

a. Providing investment advice is commercial activity "in which speech is an essential but subordinate component." *Ohralik* v. *Ohio State Bar Association,* 436 U.S. at 457. In *Ohralik,* this Court stated that the government "does not lose its power to regulate commercial activity deemed harmful to the public whenever speech is a component of that activity" (*id.* at 456) and pointed to

> [n]umerous examples * * * of communications that are regulated without offending the First Amendment, such as the exchange of information about securities, *SEC* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833 (CA 2 1968), cert. denied, 394 U.S. 976 (1969), corporate proxy statements, *Mills* v. *Electric Auto-Lite Co.,* 396 U.S. 375 (1970), the exchange of price and production information among competitors, *American Column & Lumber Co.* v. *United States,* 257 U.S. 377 (1921), and employers' threats of retaliation for the labor activities of employees, *NLRB* v. *Gissel Packing Co.,* 395 U.S. 575, 618 (1969).

Ibid. Speech related to commercial activity is not afforded any special protection merely because the speaker chooses to publish it, rather than to communicate it in person. It is

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[7] Another proceeding is pending before the Seventh Circuit involving the same publisher. There, the First Amendment question is raised in the context of revocation of the adviser's registration. *Suter* v. *SEC,* No. 83-3011.

firmly established that a "business 'is not immune from regulation because it is an agency of the press. The publisher of a newspaper has no special immunity from the application of general laws * * *.'" *Curtis Publishing Co.* v. *Butts,* 388 U.S. 130, 150 (1967) (quoting *Associated Press* v. *NLRB,* 301 U.S. 103, 132, 133 (1937)).

This Court has consistently recognized that licensing of the professions clearly falls within the scope of legitimate government regulation of commercial activity.[8] *Goldfarb* v. *Virginia State Bar,* 421 U.S. 773, 792 (1975). In *Ohralik, supra,* for example, the Court affirmed an order suspending an attorney indefinitely from the practice of law despite his First Amendment challenge, stating that the government "bears a special responsibility for maintaining standards among members of the licensed professions" (436 U.S. at 460).

The government's interest in regulating the professions extends to investment advisers, whether they provide individualized advice or advise their clients through publications.[9] The investment advisory profession is "an occupation which can cause havoc unless engaged in by those with

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[8]The regulation of Lowe's commercial advisory business does not restrain him from engaging in other activities. Petitioners do not raise before this Court the argument, properly rejected by the court of appeals (Pet. App. A13), that Lowe's publications come within the "bona fide newspaper" exception to the Act (Section 202(a)(11)(D), 15 U.S.C. 80b-2(a)(11)(D)).

[9]Petitioners' argument (Pet. 11-12) that the statutory exemption from regulation for "bona fide newspaper[s]" and certain other publications (Section 202(a)(11)(D), 15 U.S.C. 80b-2(a)(11)(D)) unconstitutionally discriminates against investment advisory publications plainly lacks merit. As the court of appeals stated (Pet. App. A15-A16 n.5), Lowe's publications constitute commercial activity that is properly distinguished from the type of speech exempted by Section 202(a)(11)(D). See *SEC* v. *Wall Street Transcript Corp.,* 422 F.2d 1371, 1378-1379 (2d Cir.), cert. denied, 398 U.S. 958 (1970). If regulation of investment

appropriate background and standards." *Marketlines, Inc.* v. *SEC,* 384 F.2d 264, 267 (2d Cir. 1967), cert. denied, 390 U.S. 947 (1968) (affirming revocation of an advisory publisher's registration). Congress, in studying the investment advisory profession prior to passage of the Act, found that the public interest requires that investment advisers be persons with high ethical standards, since opportunities for fraud and deception abound in the profession.[10] National regulation of investment advisory *publishers,* who were expressly included by Congress under the statutory definition of investment advisers,[11] was deemed necessary because of "their potential influence on security markets and the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors * * *."[12] Congress recognized that investment advisory publishers were "open to suspicion of willingly lending themselves to the use of stock market promoters and manipulators who seek to influence the course of security prices through the use of propaganda."[13]

In *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 181 (1963), this Court described the abusive practice of "scalping." In that case, a registered investment adviser purchased securities prior to recommending them to his clients in a newsletter, and then immediately sold upon the

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advice is otherwise proper, it cannot be considered constitutionally infirm simply because publications as to which there is little "likelihood that the wrongdoing which the Act was designed to prevent has occurred" (422 F.2d at 1377 (footnote omitted)) are excepted from such regulation.

[10]*Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 1008 (1940) [hereinafter *Senate Hearing*].

[11]See Section 202(a)(11) of the Act, 15 U.S.C. 80b-2(a)(11).

[12]S. Rep. 1775, 76th Cong., 3d Sess. 21 (1940).

[13]*Senate Hearing* 1008.

rise in market price following the recommendation. The Court thoroughly reviewed the legislative history of the Act and found that Congress intended to subject publishers of investment advisory services to regulation, and to recognize under federal law the fiduciary relationship that exists between investment advisory publishers and their clients. *Id.* at 187 n.15, 191, 194. This fiduciary relationship in itself provides the government with a substantial interest in protecting investors by regulation of the activities of investment advisory publishers. See, *e.g., Ohralik,* 436 U.S. at 460-461; *Halsted* v. *SEC,* 182 F.2d 660, 668 (D.C. Cir.), cert. denied, 340 U.S. 834 (1950).[14]

b. The Act's regulation of investment advisory publications is also proper because such publications are entitled to only the limited First Amendment protection accorded "commercial speech." The court of appeals correctly concluded that the commercial speech doctrine is broad enough to include the Lowe publications (Pet. App. A17). Although this Court's commercial speech cases have dealt primarily with restrictions on advertising, they do not require that the

[14]Petitioners argue (Pet. 8-9) that the Act's regulation is excessive because the denial or revocation of registration constitutes a "prior restraint" on all future publication. But while barring persons from practicing a profession on the ground of misconduct may be characterized as a prior restraint on speech (*e.g.,* licensing of lawyers and teachers), revocation of a professional license, as noted by the court of appeals, is a necessary and traditional means of protecting the public from persons who are unfit to engage in the profession (Pet. App. A18-A19). Without the authority to deny or revoke an adviser's registration, the Commission would have no adequate means of protecting the public from persons who, like Lowe, have demonstrated their unfitness to engage in a profession involving fiduciary relationships; the Commission would be relegated to seeking sanctions after the injurious conduct had occurred while the individual is permitted to continue giving advice. If publishers of investment advice can properly be subjected to registration requirements, no purpose would be served by denying the courts the authority to issue an injunction that prohibits publication of investment advice by an adviser who is not registered.

commercial speech doctrine be limited to advertising.[15] See generally *Bolger* v. *Youngs Drug Products Corp.,* No. 81-1590 (June 24, 1983), slip op. 6-7 & n.14; *Friedman* v. *Rogers,* 440 U.S. 1, 10 n.9 (1979); *Bates* v. *State Bar of Arizona,* 433 U.S. 350, 363 (1977); *Virginia State Board of Pharmacy* v. *Virginia Citizens Consumer Council, Inc.,* 425 U.S. 748, 761 (1976).

The rationale used by this Court for permitting diminished First Amendment protection for commercial speech fully supports affording Lowe's publications the same level of diminished First Amendment protection. Commercial speech derives its constitutional value solely because of the role it performs in our free enterprise economy: "[T]he allocation of our resources in large measure will be made through numerous private economic decisions. It is a matter of public interest that those decisions, in the aggregate, be intelligent and well informed." *Virginia Pharmacy,* 425 U.S. at 765. See also *Bates,* 433 U.S. at 364. Investment advisory publications serve the same societal purposes as the communications at issue in this Court's commercial speech cases. Rather than providing a general forum for social, political or religious information, they seek to advise clients on the relative merits of various investments and as

[15]One court of appeals has suggested in dictum that commercial speech is confined to advertising (see *Ad World, Inc.* v. *Township of Doylestown,* 672 F.2d 1136, 1140 (3d Cir.), cert. denied, 456 U.S. 975 (1982)). The court in *Ad World* was reviewing regulation of a newspaper that contained both editorials and advertising. Its decision was based on the undeniably noncommercial content of the editorials (672 F.2d at 1139-1140), not on a limitation of commercial speech to advertising. The commercial speech rationale in the instant case, moreover, was an alternate ground of decision (Pet. App. A17). Thus, there is no conflict requiring resolution by this Court. Moreover, the dictum in *Ad World* fails to take into account the unquestionably proper regulation of speech in a wide variety of commerical contexts apart from advertising, such as misrepresentation and labeling. See, *e.g., Corn Products Refining Co.* v. *Eddy,* 249 U.S. 427 (1919).

such merely recommend commercial transactions. The purpose of investment advice such as that at issue here "is strictly business" (*Friedman* v. *Rogers*, 440 U.S. at 11), and the advisory publications do no more than "inform private economic decisions" (*Village of Schaumburg* v. *Citizens for a Better Environment*, 444 U.S. 620, 632 (1980)). As such, they are entitled to less First Amendment protection than other constitutionally safeguarded forms of expression. *Bolger* v. *Youngs Drug Products Corp.*, slip op. 4-5; *Central Hudson Gas & Electric Corp.* v. *Public Service Commission*, 447 U.S. 557, 562-563 (1980); *Virginia Pharmacy*, 425 U.S. at 771-772 n.24.[16] As this Court noted in *Ohralik*, 436 U.S. at 456:

> To require a parity of constitutional protection for commercial and noncommercial speech alike could invite dilution, simply by a leveling process, of the force of the Amendment's guarantee with respect to the latter kind of speech. Rather than subject the First Amendment to such a devitalization, we instead have afforded commercial speech a limited measure of protection, commensurate with its subordinate position in the scale of First Amendment values * * *.[17]

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[16]Petitioners' publications therefore differ significantly from the types of speech at issue in *First National Bank* v. *Bellotti*, 435 U.S. 765 (1978) (lobbying on tax legislation), and *Thornhill* v. *Alabama*, 310 U.S. 88 (1940) (peaceful labor picketing), relied upon by petitioners (Pet. 9).

[17]Petitioners' reliance (Pet. 10) on *Bose Corp.* v. *Consumers Union*, No. 82-1246 (Apr. 30, 1984), is misplaced. *Bose* addressed only the proper standard of appellate review of an "actual malice" determination where the libel rule of *New York Times Co.* v. *Sullivan*, 376 U.S. 254 (1964), was applied. The Court in *Bose* did not address the reach of the First Amendment in licensing or commercial contexts, or even in the product disparagement situation raised in that case (slip op. 6 n.8).

Petitioners also argue (Pet. 11) that even if the Lowe advisory publications are commercial speech, the court of appeals should not have

Regulation of published investment advice, including revocation of an adviser's registration, is proper under the commercial speech doctrine because it is no more extensive than is necessary to achieve the government's substantial interest in maintaining the standards of the investment advisory profession in order to protect investors. See *Central Hudson*, 447 U.S. at 565-566; *United States* v. *O'Brien*, 391 U.S. 367, 377 (1968). See also *Members of the City Council* v. *Taxpayers for Vincent*, No. 82-975 (May 15, 1984), slip op. 17-20; pages 8-10, *supra*.

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upheld a ban on their publication because the Commission failed to show that any investment information in them was actually deceptive. But, as Congress found in studying the investment advisory profession, when persons, like Lowe, of questionable honesty and integrity publish investment advice, their publications are potentially deceptive (*Senate Report* 21). This potential for deception provides an ample basis for regulating the publications as commercial speech. See *Ohralik*, 436 U.S. at 464-465 (upholding ban on speech that was "conducive" to deception and overreaching as a "prophylatic measure[] whose objective is the prevention of harm before it occurs"); *Friedman* v. *Rogers*, 440 U.S. at 12-13, 15 (approving total ban by Texas on optometrists' use of trade names because such use was conducive to deception and manipulation, thus leading to "a significant *possibility* that trade names will be used to mislead the public" (emphasis added)). See also pages 9-10, *supra*; Pet. App. A18-A19.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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